

Official Transcript of Proceedings

Before the

UNITED STATES POSTAL RATE COMMISSION

In the Matter of: SPECIAL SERVICES FEES AND
CLASSIFICATIONS

Docket No. MC96-3

VOLUME 10

HEARING

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Washington, D.C. 20005
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1 BEFORE THE
2 POSTAL RATE COMMISSION

3 - - - - - X

4 In the Matter of: :

5 SPECIAL SERVICES FEES AND : Docket No. MC96-3

6 CLASSIFICATIONS :

7 - - - - - X

8
9 Third Floor Hearing Room
10 Postal Rate Commission
11 1333 H Street, N.W.
12 Washington, D.C. 20268

13
14 Volume 10
15 Tuesday, December 17, 1996

16
17 The above-entitled matter came on for hearing,
18 pursuant to notice, at 9:32 a.m.

19

20 BEFORE:

21 HON. EDWARD J. GLEIMAN, CHAIRMAN

22 HON. W.H. "TREY" LeBLANC, III, VICE CHAIRMAN

23 HON. H. EDWARD QUICK, JR., COMMISSIONER, PRESIDING

24 HON, GEORGE W. HALEY, COMMISSIONER

25

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2 On behalf of the United States Postal Service:

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1 C O N T E N T S

2 RULINGS BY THE PRESIDING OFFICER: PAGE

3 [None.]

4

5 WITNESS DIRECT CROSS REDIRECT RECROSS

6 ALTAF H. TAUFIQUE

7 BY MR. ALVERNO 3631

8

9 DOCUMENTS TRANSCRIBED INTO THE RECORD: PAGE

10 Rebuttal Testimony of Altaf H. Taufique, USPS-RT-2 3634

11

12 E X H I B I T S

13 EXHIBITS AND/OR TESTIMONY IDENTIFIED RECEIVED

14 Rebuttal Testimony of Altaf H.

15 Taufique, USPS-RT-2 3633

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P R O C E E D I N G S

[9:32 a.m.]

COMMISSIONER QUICK: Today, we resume hearings in Docket Number MC96-3, considering Postal Service requests for changes in special service classifications and fees.

Three witnesses are scheduled to testify on behalf of the Postal Service today.

Before we begin, I have several procedural matters to take care of. First, I am hopeful that today will be the last day of evidentiary hearings in this case. I plan to close the evidentiary record as promptly as possible. I recognize that we are into the holiday period and I do not want to ruin anyone's holiday. I will allow a little more time than normal for concluding our housekeeping tasks and I ask that participants try to meet these deadlines so that this case can be concluded in an orderly fashion.

Transcript corrections for yesterday and today are to be filed by close of business December 27, 1996. In preparing transcript corrections, please recall that corrections are to be limited to things that correct substantive meaning or prevent potential confusion. It is not necessary to correct the reporter's punctuation.

I will also set December 27 as the date for submitting all additional designations of discovery responses for incorporation into the record. At yesterday's

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1 hearing, the Postal Service indicated it had designations to
2 make and Nashua-Mystic-Seattle have already filed additional
3 designations of Postal Service responses.

4 Additionally, I just issued a Presiding Officer's
5 Information Request and there have been questions from the
6 Bench which the Postal Service has undertaken to answer. It
7 is my current intention to incorporate these answers into
8 evidence. As is our practice, I will have a volume of
9 transcript prepared which will contain materials designated
10 by December 27.

11 Next, I turn to motions from Douglas Carlson to
12 compel responses to interrogatories. In a motion dated
13 December 3, Mr. Carlson posed a question following up on a
14 Postal Service response to a Presiding Officer's Information
15 Request. The Postal Service argues that a Presiding
16 Officer's Information Request is not discovery and that
17 therefore a followup question is not appropriate.

18 I find the Postal Service distinction without
19 substantive merit. Interrogatory DFC-UPS-the-11 can
20 reasonably be viewed as follow-up and the Postal Service is
21 directed to respond by December 23.

22 Finally, Mr. Carlson filed a motion to compel
23 responses to six interrogatories he addressed to the Postal
24 Service. Mr. Carlson previously submitted a motion for an
25 extension of time to submit his motion which he believed to

1 be due on December 9. In fact, Mr. Carlson mailed his
2 motion to compel on December 9. Unfortunately, the
3 Commission did not receive this motion until the morning of
4 December 16, even though it was postmarked December 9. I
5 suspect the Postal Service may not have received a copy of
6 this motion much before that.

7 Can Postal Service counsel indicate, first,
8 whether the Service has a copy of this motion and, second,
9 how soon it can provide a response?

10 Mr. Rubin? Mr. Hollies?

11 MR. RUBIN: We do have Mr. Carlson's motion and we
12 think we can get an answer ready by next Monday.

13 COMMISSIONER QUICK: Any chance of doing it by the
14 19th?

15 MR. RUBIN: I am not -- I don't -- I think that
16 would be very difficult. That is two days from now and
17 there are some other matters that have come up that the
18 responsible attorneys have to work on this week so there is
19 a conflict there.

20 COMMISSIONER QUICK: the 23rd is the best you can
21 do?

22 MR. RUBIN: Yes.

23 COMMISSIONER QUICK: Okay, we will take the 23rd.

24 MR. RUBIN: Thank you.

25 COMMISSIONER QUICK: Yesterday, Ms. Duchek

1 provided a report on the Postal Service efforts to evaluate
2 materials provided by MMA Witness Bentley while he was being
3 cross-examined. I understand that process is continuing. I
4 have several points to make concerning that general topic.

5 The Postal Service submitted a motion for
6 reconsideration of Presiding Officer's Ruling 28 which
7 denied a motion to strike the materials Witness Bentley
8 provided during cross-examination allowed for discovery on
9 that material. Ruling Number 28 held that the Postal
10 Service had not been denied due process but since MMA had
11 cooperatively agreed to respond to any additional inquiries
12 the Postal Service might have concerning these materials, I
13 allowed discovery to take place.

14 The motion for reconsideration is denied. It
15 raises no new issues. The Postal Service again expresses
16 concern that it will not have a full opportunity to question
17 Mr. Bentley and to present rebuttal to the materials in
18 question. The Postal Service has already submitted
19 questions and follow-up questions to Witness Bentley.
20 According to Ms. Duchek's statement yesterday, the Service
21 has submitted still more follow-up questions.

22 I think it is evident from this history that the
23 Postal Service has had more than an adequate opportunity to
24 explore issues raised by the cross-examination of this
25 witness. In fact, I would like to take this opportunity to

1 publicly express my appreciation to Major Mailers
2 Association for responding so promptly to the Postal Service
3 questions.

4 Ruling 28 contemplated that requests for further
5 procedural steps would be made by December 16. Considering
6 the status of this case, I will expect the Postal Service to
7 submit any such request by close of business December 18.
8 If the Postal Service seeks the opportunity to submit
9 additional testimony, the Postal Service is to notify
10 counsel for MMA and if MMA indicates it may oppose that
11 request, the Postal Service is to provide actual service of
12 its request to MMA counsel at the same time it files that
13 request with the Commission.

14 I understand that as of this morning, Nashua-
15 Mystic-Seattle has now withdrawn their request to change the
16 domestic mail classification schedule language applicable to
17 Business Reply Mail. No other participant has offered a
18 proposal for any testimony concerning Business Reply Mail
19 classifications.

20 Under this circumstance, the testimony of Postal
21 Service Witnesses DeMay and Infante are not relevant
22 rebuttal to any proposal pending before the Commission.
23 Therefore, it is appropriate for the Postal Service to
24 withdraw this testimony.

25 Do any participants wish to elaborate further on

1 the withdrawal of the request made this morning?

2 Mr. Olson?

3 MR. OLSON: William Olson representing Nashua,
4 Mystic and Seattle. I do want to, in the spirit of the
5 holiday season that you alluded to earlier, say that we are
6 pleased to be able to do this and withdraw the proposal that
7 we have made heretofore in this docket as advanced by
8 Dr. Haldy for the creation of a nonautomatable bulk special
9 service rate or fee category, rather. And having seen what
10 the Postal Service has filed last Friday with respect to the
11 creation of Docket Number MC97-1, in their proposal, we have
12 felt that it would be better to resolve the case within the
13 context of that docket and we look forward to that. It has
14 the additional benefit of giving the Commission, as they say
15 in England, a short day by taking two of the three witnesses
16 off the docket today and we are pleased to be able to do
17 that but very much grateful that the Commission was willing
18 to hear this proposal and to be able to give it an airing
19 and now, no doubt, having had some small role in putting
20 this high on the priority list of the Postal Service so that
21 it could now be the subject matter of a separate docket and
22 there has been great effort put into that by the Postal
23 Service, so that proposal, when we reviewed it over the
24 weekend, we are prepared to go ahead with that and hope that
25 that would be the solution for these mailers and others that

1 are similarly situated.

2 So we thank the Commission for your indulgence of
3 our proposal and for the Postal Service, once they realized
4 the importance and seriousness of the issue, of addressing
5 it as they have in the context of this other docket. And
6 with that, we appreciate getting permission from the
7 Commission for leave to withdraw and consider it in the
8 context of that case.

9 Thank you.

10 COMMISSIONER QUICK: Thank you, Mr. Olson. Mr.
11 Tidwell, do you wish to comment?

12 MR. TIDWELL: Yes, Commissioner Quick. The Postal
13 Service is grateful to Nashua Mystic of Seattle for taking
14 the actions they've taken. We've all along thought that the
15 resolution of business reply mail issues could be better
16 handled in a separate proceeding and we're glad that we're
17 now moving in that direction.

18 Counsel for the Postal Service would like to thank
19 Mr. Olson for his work in bringing his clients to the point
20 where things are today and we'd like to also thank
21 witnesses, almost Witnesses Infante and DeMay for the hard
22 work they put into preparing testimony.

23 This resolution has the added benefit of allowing
24 Witness DeMay to fly back to Youngstown today to finish
25 preparations for a 25th wedding anniversary celebration

1 which is tomorrow.

2 COMMISSIONER QUICK: Thank you, Mr. Tidwell. Mr.
3 Chairman?

4 CHAIRMAN GLEIMAN: I, too, am pleased that
5 everyone has been able to work this out to their
6 satisfaction and a separate case has been filed, but I don't
7 know whether it's the Ghost of Christmas Past or the Ghost
8 of Christmas Future that bothers me. Perhaps it's the Ghost
9 of Christmas Past.

10 Just last year, right before Christmas, we
11 received an experimental case filed with a request for
12 expedited treatment and again this year, the Commission is
13 faced with another experimental case filed shortly before
14 the Christmas/New Year's holidays, again with a request for
15 expedited treatment. I hope that the Ghost of Christmas
16 Future portends something better.

17 I'm glad that Mr. DeMay is able to celebrate his
18 25th anniversary a little bit more comfortably than he might
19 have otherwise been able to. Inasmuch as the case was filed
20 at 4:59 p.m. on Friday afternoon the 13th, I would hope that
21 while the Commission will endeavor, I'm sure, under the
22 guidance of the Presiding Officer to be, in that case,
23 Commissioner LeBlanc, will endeavor to finish in the
24 expedited period.

25 You will all understand if we take a teeny bit

1 longer given the intervening holidays and the late hour of
2 the day in which that case was filed, but again, we're
3 pleased that you're able to work out some of these problems.

4 MR. TIDWELL: Thank you, Mr. Presiding Officer.

5 COMMISSIONER QUICK: Thank you very much for
6 working this out, I'm sure it will lift the holiday spirits
7 of everyone associated with this case except the Commission
8 staff perhaps at least for a short term, and we certainly
9 wish Mr. DeMay a happy 25th wedding anniversary.

10 Does anyone else have procedural matters to bring
11 up before we begin today?

12 [No response.]

13 COMMISSIONER QUICK: If not, Mr. Alverno, will you
14 call your witness so that I can swear him in?

15 MR. ALVERNO: Thank you, Mr. Presiding Officer.
16 The Postal Service calls Altaf Taufique.
17 Whereupon,

18 ALTAF H. TAUFIQUE,
19 a witness, was called for examination by Counsel for the
20 United States Postal Service and, having been first duly
21 sworn, was examined and testified as follows:

22 DIRECT EXAMINATION

23 BY MR. ALVERNO:

24 Q Please introduce yourself?

25 A My name is Altaf H. Taufique.

1 Q Where are you employed?

2 A I'm employed by the U.S. Postal Service in the
3 Pricing Division.

4 Q Sir, earlier I handed you two copies of a document
5 entitled, "Rebuttal Testimony of Altaf H. Taufique on behalf
6 of the United States Postal Service." Have you had a chance
7 to review those documents?

8 A Yes, I did review them.

9 Q And they are marked as USPS-RT-2. Was this
10 testimony prepared by you or under your direction?

11 A Yes, it was.

12 Q And do you have any changes or corrections to
13 make?

14 A One minor change that I have is on page four,
15 footnote 3. It should read, "See example, USPS-RT-3 at 20-
16 21," instead of 17.

17 Q Is that change reflected in the copies with the
18 reporter?

19 A It sure is.

20 Q With these changes, if you were to testify orally
21 today, would your testimony be the same?

22 A Yes, it would.

23 MR. ALVERNO: Mr. Presiding Officer, I ask that
24 the rebuttal testimony of Altaf H. Taufique on behalf of
25 United States Postal Service, marked as USPS-RT-2, be

1 received as evidence at this time.

2 COMMISSIONER QUICK: Are there any objections?

3 [No response.]

4 COMMISSIONER QUICK: Hearing none, Mr. Taufique's
5 testimony and exhibits are received into evidence.

6 [The Rebuttal Testimony of Altaf H.
7 Taufique, USPS-RT-2, was received
8 into evidence and transcribed into
9 the record.]

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USPS-RT-2

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

SPECIAL SERVICES REFORM, 1996

Docket No. MC96-3

REBUTTAL TESTIMONY
OF
ALTAF H. TAUFIQUE
ON BEHALF OF
UNITED STATES POSTAL SERVICE

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AUTOBIOGRAPHICAL SKETCH

1 My name is Altaf H. Taufique. I currently serve as an economist in the
2 office of Pricing at the United States Postal Service. Prior to joining the Postal
3 Service in July 1996, I was employed by the Gulf States Utilities Company
4 (GSU) in Beaumont, Texas from 1980 to 1994. At GSU, I served as an
5 economic analyst in the Corporate Planning department and was subsequently
6 promoted to Economist, Senior Economist and finally to the position of Director,
7 Economic Analysis and Forecasting. My responsibilities at GSU included the
8 preparation of the official energy, load and short-term revenue forecasts, and the
9 economic forecasts for the regions served by the Company. I have testified
10 before the Public Utility Commission of Texas in Austin and the Federal Energy
11 Regulatory Commission in Washington, D.C. My testimony defended GSU's
12 official energy and load forecasts. This is my first appearance before the Postal
13 Rate Commission.

14 I received a Master's Degree in Economics from Central Missouri State
15 University in Warrensburg, Missouri in 1976, and a Bachelor's degree in
16 Economics & International Relations from Karachi University in Karachi,
17 Pakistan. I have also completed thirty-three credit hours of coursework towards
18 a Ph.D. in Economics at Southern Illinois University. I taught economics at
19 Chadron State College in Chadron, Nebraska between 1978 and 1980, and
20 during my employment at GSU in Texas, I taught courses in economics at Lamar
21 University in Port Arthur, Texas.

1 I. PURPOSE OF TESTIMONY

2
3 The purpose of my testimony is to rebut the testimonies of OCA witnesses
4 Sherman and Thompson, which oppose the Postal Service's fee and
5 classification proposals for selected special services. I begin by demonstrating
6 an apparent inconsistency between witness Thompson's criticism of the proposal
7 to increase fees for selected special services while maintaining rate stability for
8 First-Class Mail with Dr. Sherman's past writings. Next, my testimony shows
9 why the use of market prices as a means of determining value is appropriate in
10 postal ratemaking. My testimony then challenges Dr. Sherman's contention that
11 the post office box proposal is an exercise of the Postal Service's monopoly or
12 market power in the box market. Finally, I address Dr. Sherman's concern
13 regarding the pricing of post office boxes with a single rate structure.

14
15
16 II. WITNESS THOMPSON'S CRITICISMS APPEAR TO BE INCONSISTENT
17 WITH DR. SHERMAN'S PAST WRITINGS.
18

19 Witness Thompson reserves her harshest criticism for the decision to
20 maintain First-Class Mail rate stability while increasing fees for the selected
21 special services. Her testimony labels this aspect of the Postal Service's
22 proposal as "unfair," "inequitable," and "capricious."¹ Witness Thompson's
23 criticism is baffling because it appears to be inconsistent with concerns

¹ Tr. 5/1364.

1 expressed by several observers, including OCA witness Sherman, that postal
2 cost allocations and pricing have operated to the detriment of those mailers,
3 particularly First-Class mailers, whose alternatives to mail delivery are limited by
4 the Private Express Statutes. It is ironic that, in a case in which the Postal
5 Service would obtain additional revenues from categories other than First-Class
6 Mail, Dr. Sherman has opposed such a proposal.

7 Dr. Sherman has written extensively on postal pricing issues in the past,²
8 and has appeared as an expert witness in several Commission proceedings. His
9 past writings and testimony reveal a consistent theme that appears to be
10 inconsistent with his and witness Thompson's analysis of the proposals in this
11 docket. The gist of his writings is that monopoly products, especially First-Class
12 Mail, have contributed the lion's share of the recovery of institutional costs, and
13 other postal products have received rather favorable treatment at the expense of
14 this low elasticity, monopoly product. For instance, in an article written with
15 James C. Miller, III, Dr. Sherman criticized excessive institutional cost burdens
16 borne by First-Class Mail:

17 We do not mean to imply that attributing cost to classes of mail is a
18 simple task for, as Fuss indicates, the problem is a difficult one. But if
19 costs are traced only partially to mail classes and inverse elasticity
20 rule is applied, resulting prices may exploit the classes of mail where
21 monopoly power is greatest. Prices will be high, not necessarily
22 because costs of providing services are great but because monopoly
23 power is high as indicated by less elastic demand. And where .

² See Tr. 7/2308-13.

1 demand is more elastic, perhaps because competing services exist,
2 prices may be set low, even below true marginal costs.³

3
4 Dr. Sherman and his co-author reaffirmed their criticism when they quote the
5 administrative law judge in Docket No. R74-1 with approval:

6 The Postal Service has become a tax collecting agency, collecting
7 money from [F]irst-[C]lass mailers to distribute to other favored
8 classes. Every time a person pays 10 cents to mail a [F]irst-[C]lass
9 letter he is paying his appropriate attributable cost plus his
10 proportionate share of residual cost, and in addition, he is contributing
11 almost 2 cents to pay the costs of other services.⁴

12
13 Dr. Sherman re-emphasized these criticisms in another essay:

14 The USPS initially argued that most of its costs were fixed and
15 independent of the volume of mail it handled; it claimed it could
16 assign or attribute less than half its total costs to individual mail
17 services, with the result that the fractions of costs that varied with
18 volumes of those services were very low. When used as a basis for
19 setting welfare-maximizing Ramsey prices, these cost representations
20 would lead to a relatively high rate for first class mail, where the postal
21 monopoly resulted in the lowest elasticity of demand, and low rates
22 for other classes, where there was more competition.

23 * * * * *

24 For its part, the USPS presented cost analyses at rate hearings that
25 quite obviously were designed to sustain the long existing rate
26 structure, to keep the rate high where monopoly power was greatest,
27 on [F]irst-[C]lass mail, and to offer relatively low rates on other
28 classes of mail.⁵

29
30 Dr. Sherman has not changed his view on this subject. As recently as Docket
31 No. R94-1, when discussing the relative merits of Ramsey pricing versus equal

³ J.C. Miller, III, & R. Sherman, *Has the 1970 Act Been Fair to Mailers*, in PERSPECTIVES ON POSTAL SERVICE ISSUES 62-63 (R. Sherman, ed., 1980) (footnote omitted).

⁴ *Id.* at 64 (quoting Docket R74-1, vol. 1, p. 13).

⁵ R. Sherman, *Competition in Postal Service*, in COMPETITION AND INNOVATION IN POSTAL SERVICE 193-94 (M.A. Crew & P.R. Kleindorfer, eds., 1990).

1 markups, Dr. Sherman warned against pricing "monopolized services,"

2 presumably First-Class Mail, too high:

3 The temptation then to choose low markups for more competitive
4 services with high perceived demand elasticities could be very great,
5 and the result might be underpricing of those services relative to their
6 true costs, while monopolized services are overpriced.⁶

7
8
9 Dr. Sherman's past writings cautioned against the adoption of pricing
10 approaches that led to higher rates for First-Class Mail while keeping rates for
11 more competitive products lower. The fee change proposals for post office
12 boxes and certified mail in this case appear to be consistent with Dr. Sherman's
13 view, because fees for these services, for which there are alternative providers
14 of similar types of services,⁷ are being raised to achieve modest objectives, *i.e.*,
15 to cover their attributable costs or provide a reasonable contribution to
16 institutional costs, or both.⁸ Thus, one would expect the OCA to view the fee
17 change proposals more charitably, particularly given Dr. Sherman's writings on
18 this subject.

⁶ Docket No. R94-1, OCA-T-400 at 9, Tr. 12B/5516.

⁷ See, e.g., USPS-RT-3 at 17, USPS-T-4 at 15-33, USPS-T-7 at 39 and USPS-T-8 at 72-73. 20-21

⁸ See generally USPS-T-1, USPS-T-7 and USPS-T-8.

1
2 III. MARKET PRICES CAN BE USED TO DETERMINE THE VALUE OF
3 POSTAL PRODUCTS.
4

5 Dr. Sherman states that, "[t]he Postal Service proposal in Docket No.
6 MC96-3 has features that are unusual. First, it focuses on only a few special
7 services, rather than all services. Second, it gives attention to something called
8 marketplace considerations"⁹ He finds the terms used by witness Lyons to
9 describe the Postal Service's proposals, such as "economically rational", and
10 "businesslike basis,"¹⁰ to be "vague."¹¹ Dr. Sherman dismisses witness Lyons'
11 statement that prices for services at issue here reflect marketplace
12 considerations, as well as the cost of providing services, as "nice sounding but
13 still vague."¹² He further goes on to say that, "[i]t is not at all clear what market-
14 based prices are. They are not defined well enough to be related to principles of
15 optimal pricing."¹³

16 Dr. Sherman's professed unfamiliarity with the meaning of market-based
17 prices in this case appears to contradict his previous, published remarks. In his
18 highly regarded text on antitrust, Dr. Sherman wrote:

19 market prices actually can guide production. For example,
20 suppose a good's competitive market price were well above the
21 long-run cost of production. This would mean that consumers
22 valued that good at more than it would cost to produce it on a long-

⁹ Tr. 7/2274.

¹⁰ USPS-T-1 at 2.

¹¹ Tr. 7/2274.

¹² Tr. 7/2274.

¹³ Tr. 7/2275.

1 run basis. So there would be high profit that would spur expansion
2 by existing producers and invite entry by new producers. A system
3 of competitive markets would move resources – capital, workers,
4 managers, materials – to increase the production of these goods
5 that consumers valued so much. The expanded quantities would
6 make the goods more plentiful and force market prices down again
7 until it was again close to the cost of production so further
8 expansion of output no longer was motivated.¹⁴

9
10 The Postal Service's fee proposals in this docket combine market
11 information with the pricing criteria in section 3622 to better reflect value to
12 customers and to have the services at issue here make more reasonable
13 contributions. Indeed, the Postal Service collected substantial research on
14 marketplace conditions to inform its pricing proposals. For example, with respect
15 to the post office box proposal, the Postal Service conducted a post office box
16 study,¹⁵ a study of CMRAs,¹⁶ and market research to measure customer reaction
17 to a range of fee increases for post office boxes.¹⁷ These studies have enabled
18 the Postal Service to acquire new information about the box market, including
19 supply and utilization rates, the presence of competition, the value of this service
20 to its own customers, and the revealed preference of its competitors' customers.

21 The terms "marketplace considerations", "businesslike basis" and
22 "economically rational" are neither "vague," nor unfamiliar. They are the

¹⁴ R. Sherman, ANTITRUST POLICIES AND ISSUES 7 (1978).

¹⁵ USPS-T-4, at 3-13.

¹⁶ USPS-T-4, at 15-33.

¹⁷ USPS-T-6.

standards of basic economics and have well-defined meanings. Socially optimal pricing must rely upon them.

IV. THERE IS NO EVIDENCE THAT THE POSTAL SERVICE HAS MONOPOLY POWER IN THE BOX MARKET.

Dr. Sherman states that, "[s]ince the Postal Service has economies of scope in providing post office box service, and may even avoid some cost of delivery in doing so, there is little doubt that alternative box services are more costly. The Postal Service has market power, in other words, in the market for post office boxes."¹⁸ In his written testimony, Dr. Sherman defines market or monopoly power in the context of the Postal Service as follows:¹⁹

Having alternative services available only at higher prices means the Postal Service has market power. The point has been made often: monopoly power is present when a firm is sufficiently insulated from competitive pressures to be able to raise prices . . . without concern for its competitors actions because its rivals cannot offer customers reasonable alternatives.²⁰

Dr. Sherman cites Fisher, et al., FOLDED, SPINDLED, AND MUTILATED: ECONOMIC ANALYSIS OF US vs. IBM, in support of his definition of market and monopoly power. The underlying source Dr. Sherman cites, however, is not consistent with his monopoly theory. Indeed, during oral cross-examination, Dr. Sherman

¹⁸ Tr. 7/2303.

¹⁹ Dr. Sherman uses the terms "market power" and "monopoly power" interchangeably. See, e.g., Tr. 7/2354.

²⁰ Tr. 7/2277.

1 essentially conceded as much.²¹ A more complete definition of market or
2 monopoly power is found on page 20 of FOLDED, SPINDLED, AND MUTILATED. In
3 essence, market power involves more than the mere power to raise price; rather,
4 it is exhibited when the firm has the ability to raise price above competitive levels
5 without losing market share.²² Fisher, *et al.*, observe:

6 A firm has monopoly power when it is sufficiently insulated from
7 competitive pressures to be able to raise its prices or withhold the
8 introduction of new technology, either in product innovations or in
9 process (cost reducing) innovations, without concern about the
10 actions of its competitors and with relative impunity because its
11 customers lack reasonable alternatives to which to turn. Monopoly
12 power is the ability to raise prices above competitive levels or to

²¹ When asked if monopoly power was exhibited when a firm had the power simply to raise price, or to raise price above competitive levels, Dr. Sherman conceded that "[a]bove competitive levels would be preferable, more exact." Tr. 7/2449.

²² A common misconception is that market share is, in and of itself, indicative of monopoly power. Fisher, *et al.*, in FOLDED, SPINDLED, AND MUTILATED, the same source Dr. Sherman cites in his testimony, explain that the two do not necessarily go hand-in-hand. The authors state that "market share can be high for more than one reason. One such reason, of course, is monopoly power. However, a firm may have a large market share by reason of being there first." Fisher, *et al.*, FOLDED, SPINDLED, AND MUTILATED: AN ECONOMIC ANALYSIS OF U.S. v. I.B.M 99 (1983). Indeed, a large market share does not, in and of itself, confer monopoly power:

a firm's large market share does not imply power if firms not in the market can readily enter or if existing firms (whatever their share) can readily expand so that customers will have realistic alternatives if the given firm attempts to raise prices or hold back technology."

Id. at 99. They also add that "[t]he crucial question is not what market share *is* but what it would *become* were the firm to attempt to exercise monopoly power. This is the question of ease with which buyers can turn to other sellers and substitute products and the readiness with which competitors will expand output if it appears that monopoly returns are being gained." *Id.* at 100.

1 market inferior products while excluding competition. This is the
 2 economist's version of the law's definition of monopoly as the
 3 "power to control prices or exclude competitors." The ability to gain
 4 business through lower, remunerative prices or through better
 5 products is not monopoly power but the manifestation of "superior
 6 skill, foresight, and industry."²³

7
 8 The authors add that, "[m]onopoly power is not present when a firm can keep its
 9 business only by means of *lower prices* or better products *than* its competitors'

10 ..."²⁴

11 In order for the Postal Service to exercise market or monopoly power, it
 12 must have the power to raise prices above competitive levels without losing
 13 market share. For Dr. Sherman to prove his claim that the post office box fee
 14 proposal is a manifestation of the Postal Service's monopoly power, he would
 15 have to show that prices charged by the Postal Service are presently at or above
 16 competitive levels, or that the proposed fees would qualify as such, and that the
 17 Postal Service would not lose market share. No information provided in this
 18 docket, however, supports those conclusions.

19 Indeed, statements made by Dr. Sherman appears to suggest a contrary
 20 view. First, Dr. Sherman confesses that his conclusions about CMRA costs are
 21 drawn from a review of CMRA *prices*.²⁵ Second, in order to draw conclusions
 22 about costs from prices, Dr. Sherman must also be assuming that the box

²³ Fisher et al., FOLDED, SPINDLED, AND MUTILATED: AN ECONOMIC ANALYSIS OF
 U.S. v. I.B.M 20 (1983).(footnotes omitted)

²⁴ *Id.* 99 (emphasis added).

²⁵ Tr. 7/2431-2433.

1 market is in long run equilibrium, since he supposes that the only circumstance
2 in which one can draw conclusions about costs, on the basis of prices, is when a
3 market is in long run equilibrium.²⁶ These statements imply that Dr. Sherman
4 believes that existing CMRA prices are at competitive levels. If so, as the Postal
5 Service's proposed fees are well below those of CMRAs, their adoption could not
6 constitute an exercise of market power.

7 Notwithstanding what Dr. Sherman's views may be, my own review of the
8 available information suggests that the competitive equilibrium prices for post
9 office boxes will fall somewhere below the prices currently charged by CMRAs.
10 Although it is tempting to say that the competitors' box prices are at "competitive
11 levels," the evidence shows that these types of retail outlets are experiencing
12 phenomenal growth.²⁷ Such growth is indicative of a market that is not yet in
13 long-run equilibrium, but rather one in which suppliers are earning economic
14 profits. Long-term equilibrium in a competitive market occurs when prices equal
15 marginal costs. When a market is in long-run equilibrium, sellers are unable to
16 earn economic profits, thereby discouraging new entrants to that market. The
17 substantial growth in Commercial Mail Receiving Agency (CMRA) outlets
18 demonstrates that there are no significant barriers to entry in this industry and
19 the firms in the market are earning economic profits. It is not, therefore, a market
20 in long run equilibrium.

²⁶ Tr. 7/2434.

²⁷ USPS-RT-3.

1 The very idea of determining competitive prices in the absence of market
2 forces reminds me of an old economist's joke made during the height of the
3 Cold War. It was said that the Soviets wanted to conquer the world, but they
4 wanted to let Switzerland continue to operate in a free market environment. The
5 reason: they wanted to know market prices. The information provided in this
6 docket is not sufficient to definitively establish the competitive price for post office
7 boxes. It does, however, permit drawing general inferences. I can say that the
8 competitive prices in the post office box market are above the current and
9 proposed fees in this docket, but probably below the prices charged by CMRAs.
10 The reasons for this assessment are as follows. First, CMRAs are growing at a
11 spectacular rate, which would lead one to believe that economic profits are being
12 earned. CMRA prices have to be above long-run marginal costs. Second,
13 Postal Service reported costs and fees are below what a competitive CMRA
14 market would ultimately generate, for three reasons: 1) Economies of scope, as
15 asserted by Dr. Sherman,²⁸ may give the Postal Service a cost advantage;²⁹
16 2) CMRA costs must reflect the full costs of sorting mail to individual boxes,
17 while the Postal Service can offset those costs with reduction in sorting costs
18 that have already been paid by the mailers;³⁰ and 3) As witness Lion points out,

²⁸ Tr. 7/2303

²⁹ Of course, CMRA operators can (and do) mitigate this effect by also providing other services besides box rental.

³⁰ The fact that much of the labor costs have already been paid by the mailer minimizes the impact of what are probably lower hourly labor rates paid by CMRAs.

1 space provision costs for CMRAs should be higher than those reported by the
2 Postal Service, because of the utilization of book costs rather than market
3 costs.³¹

4 Ultimately, we can only speculate whether the proposed fees are above or
5 below hypothetical fee levels under "perfect competition." Fortunately, however,
6 the applicable rate making standards do not require us to address, much less
7 resolve, this question. The existence and rapid growth of CMRAs, offering box
8 rentals at significantly higher fees, provide direct support for the Postal Service's
9 proposals under the statutory ratemaking standards. For example, the impact on
10 customers, 39 U.S.C. 3622(b)(4), cannot be considered undue when other
11 consumers are already paying higher fees to CMRAs. Moreover, for many
12 customers, CMRAs do constitute an available alternative, 39 U.S.C. 3622(b)(5).
13 In addition, if box service did not have a high value of service, 39 U.S.C 3622
14 (b)(2), customers would not be flocking to CMRAs.³² Lastly, given the situation
15 with CMRAs, it is untenable to assert that a fee increase that will result in a cost

³¹ USPS-RT-3

³² One standard approach to evaluating 39 U.S.C. 3622 (b) (2) is comparing own price elasticities of demand. This allows the "value" of different postal services to be compared. Elasticities have not customarily been used in this respect for post office boxes, however, because of the effects of the unique relationship between demand and supply for this service on observed time series. The absence of elasticity information makes it more important to observe other market features such as growth of CMRAs, their fee levels, etc., when contemplating the value of post office box service.

1 coverage that is still below the systemwide average is either "unfair" or
2 "inequitable", 39 U.S.C. 3622(b)(1).

3 Moreover, there are apparently no overwhelming barriers to entry in this
4 market, as evidenced by the explosive growth of private post office box
5 providers.³³ To the extent that there might be more limited barriers to entry, they
6 are unintended consequences of the current fee levels. Increasing fees to the
7 proposed levels might actually stimulate additional entry.³⁴ More importantly,
8 the current fee levels may constitute the practical equivalent of a barrier to entry
9 in some markets against the Postal Service. As discussed in witness Lion's
10 testimony, there are situations in which customers want boxes, are willing to pay
11 for boxes, but the Postal Service cannot expand its box operations (or establish
12 new box operations) and still cover its additional costs at the current fees that the
13 Postal Service is required to charge. These situations represent a serious
14 breakdown of the regulatory process, and cause real harm to the Postal Service,
15 its current customers who could have their institutional cost burden spread over
16 a broader base, and to prospective customers whose needs go unfulfilled. This
17 leads me to my conclusion on this subject: The Postal Service is not exercising
18 monopoly or market power in seeking to increase fees for this service to the
19 levels proposed.

20

³³ USPS-RT-3.

³⁴ Tr. 7/2390.

1
2 V. LOCAL MARKET FACTORS COULD BE USED TO SET PRICES
3 FOR POST OFFICE BOXES.
4

5 Dr. Sherman commented on the difficulty of pricing post office boxes with
6 a single rate structure that must apply nationwide.³⁵ To stimulate thinking along
7 these lines I offer the following comments.

8 The Postal Service acknowledges that a "one price fits all" approach may
9 not be the most efficient method of pricing post office boxes. The current
10 proposal is designed to begin taking differences in costs and demand into
11 account. A comprehensive consideration of the demand, supply, and cost
12 differences of post office boxes could evolve into local adjustments to prices at
13 each facility depending upon market factors. This task, of course, would present
14 administrative burdens due to the sheer size of this business, given that there
15 are over 30,000 facilities with approximately 20 million boxes of various sizes.
16 One approach could be a framework that ranks postal facilities based on factors
17 such as capacity utilization, cost of providing the service, population or
18 population density, per capita or household income, presence of competitive
19 providers and the level of service, such as lobby access hours.

20 As the Postal Service evaluates various approaches to pricing post office
21 box service in the future, it may be useful to have feedback and suggestions
22 from interested parties, including the Commission.

³⁵ Tr. 7/2296.

1 COMMISSIONER QUICK: The Office of Consumer
2 Advocate requested oral cross examination of Witness
3 Taufique. Does any other participant have oral cross
4 examination for Witness Taufique?

5 [No response.]

6 COMMISSIONER QUICK: Mr. Costich, would you please
7 begin?

8 MR. COSTICH: Thank you, Commissioner Quick.

9 BY MR. COSTICH:

10 Q Good morning, Mr. Taufique.

11 A Good morning, Mr. Costich.

12 Q Could you refer to page 1 of your testimony, lines
13 19 through 22?

14 A Yes.

15 Q Here, you say that Witness Thompson called First
16 Class rate stability unfair, inequitable and capricious; is
17 that correct.

18 A What I have said in here is that Witness Thompson
19 stated that First Class Mail rate stability, while
20 increasing the fees for the selected special services, has
21 called that inequitable, unfair and capricious.

22 Q You are citing page 1364 in the transcript; is
23 that correct?

24 A Yes.

25 Q And that is page 12 of Witness Thompson's direct

1 testimony; is that correct?

2 A Let me check.

3 Yes, I am.

4 Q Now, could you show me where on this page Witness
5 Thompson is criticizing First Class rate stability as
6 unfair, inequitable or capricious?

7 A Okay, on page 1364 of this particular transcript,
8 approval of the Postal Service's Docket Number MC96-3,
9 Request for Increased Net Revenues fosters a selective
10 pricing philosophy and it goes on to say that burdening some
11 subclasses of mail -- in fact, I should make a correction
12 over here that the part starts on page 1363 or page 11 of
13 her testimony where she talks about if the Postal Service's
14 current request for additional net revenues approved --

15 On page 1363, Witness Thompson talks about if the
16 Postal Service's current request for additional net revenues
17 is approved, then some rates will necessarily change.
18 Therefore, there will be no rate stability for those special
19 services subject to Docket Number MC96-3 and she refers to
20 Witness Lyons, L-y-o-n-s, and says that Witness Lyons is
21 identifying the basic First Class rates as the determinant
22 of rate stability and what I should have done, actually, is
23 I should have cited more pages of her testimony because she
24 has talked about and used the same terms that I am referring
25 to over here.

1 In fact, on page 1364, additional revenue was
2 entirely -- this is lines 10 and 11 -- was entirely
3 coincident, coincidental and thus capricious.

4 Q Yes, I see the words "unfair, inequitable and
5 capricious" --

6 A Right.

7 Q -- on the page you cite.

8 A Right.

9 Q What I am not seeing is a direct connection to
10 First Class rate stability.

11 A If you look at the whole paragraph or the whole
12 part in this particular -- on these pages, she is referring
13 to the First Class stability and the increase that the
14 Postal Service has proposed. That is what she is referring
15 to on page 1364.

16 Q If you would look at lines 2 through 4 on page
17 1364, here is where the words "unfair" and "inequitable"
18 show up; is that correct?

19 A Right.

20 Q And the entire sentence reads, "However, sparing
21 all other subclasses and services, rate increases at the
22 expense of a few select special services is unfair and
23 inequitable."

24 A Right.

25 Q Witness Thompson was criticizing the notion of

1 selective rate increases, not First Class rate stability,
2 right?

3 A Like I said earlier, that if you read the whole
4 thing it's very evident -- look at page 1363 and go on to
5 1364 -- she is definitely criticizing the stability that
6 witness Lyons had mentioned for First Class rates and the
7 increase that the Postal Service is proposing in this
8 particular case.

9 THE REPORTER: She is definitely questioning the
10 stability of what?

11 THE WITNESS: She is definitely questioning the
12 stability of First Class rates and the increase that the
13 Postal Service is proposing in this particular docket.

14 BY MR. COSTICH:

15 Q Could you look at lines 6 through 9 on page 1364.
16 Perhaps you read these earlier.

17 A Right.

18 Q Witness Thompson said "selectively burdening
19 classes or subclasses of mail with non-attributable net
20 income requirements violates the principles of fairness and
21 equity."

22 Again it is the selectivity that she is
23 criticizing, correct, not First Class rate stability?

24 A In the context of the section that she wrote, it
25 is very apparent that the stability of First Class rates

1 versus the selective price increases is what she is
2 criticizing.

3 Q How much First Class rate stability will result if
4 the Postal Service's proposal in this docket is approved?

5 A My testimony does not address that issue. All
6 that I am talking about is the criticism that was levied by
7 witness Thompson in this particular docket, and if you
8 compare that to Dr. Sherman's past writings, there is an
9 inconsistency between the approaches.

10 Q So you have no opinion on how much First Class
11 rate stability will result if this proposal is approved?

12 A My rebuttal testimony does not address that issue.

13 Q Could you refer to page 4 of your testimony, lines
14 11 through 16?

15 A If you could give me a minute. Okay.

16 Q Here, I understand you to be saying that Witness
17 Sherman should have supported the proposals to raise fees
18 for post office boxes and certified mail because there are
19 alternative providers of those services, is that correct?

20 A Given the criticism that Witness Sherman in his
21 writings had stated in the past, which was basically the
22 lion's share of the burden of first class, both Witness
23 Sherman and OCA should have been more charitable to this
24 particular proposal where first class rates are being held
25 stable and revenues are being raised from other services

1 where there are alternative providers.

2 Q And you don't suppose the reverse of this
3 situation is ever going to come up where the Postal Service
4 proposes selective rate increases for first class mail and
5 not for others?

6 A I'm not saying that at all. All that I'm saying
7 is that in this particular docket, it appears to me when I
8 read Witness Thompson's testimony and look at the past
9 writings of Witness Sherman, it appears to be inconsistent.

10 Q You don't think the OCA should be concerned with
11 the basic principle of selective rate increases?

12 A Again, I'm not testifying on that subject.

13 Q Let's consider post office boxes. Are you saying
14 that the existence of commercial mail-receiving agencies in
15 densely populated areas justifies doubling post office box
16 rates in sparsely populated areas?

17 A Most people who come to these witness stands over
18 here can talk about years and years of experience and in my
19 case, I can talk about my weeks and weeks of experience, so
20 I would ^{refer} ~~defer~~ to some of the things that have been said
21 earlier in some of the testimonies also, but as I understand
22 the postal ratemaking process is not just looking at one
23 criteria.

24 There is a whole set of issues we need to look at
25 in terms of pricing postal products and doubling of some

1 fees to cover the cost or at least to be able to come close
2 to covering the cost is fulfilling the criteria of postal
3 ratemaking.

4 Q At page four, you're discussing alternative
5 providers. Are you saying that the existence of alternative
6 providers in some geographic areas justifies raising the
7 rates in other geographic areas?

8 A Again, in any ratemaking process, you cannot look
9 at one particular criteria in isolation. There are a number
10 of criteria and one of them is the availability of alternate
11 providers, but there are a number of other issues that need
12 to be considered in order to have rates that would meet the
13 requirements of the pricing criteria.

14 Q A large section of your testimony deals with the
15 question of whether the Postal Service has monopoly power in
16 the post office box market, is that correct?

17 A Yes, it does.

18 Q The Postal Service has a monopoly in sparsely
19 populated areas, doesn't it?

20 A The issue of monopoly was raised by Dr. Sherman
21 for post office boxes and Dr. Sherman had stated at one
22 point, if I can ^{refer} ~~defer~~ back to my testimony on the subject,
23 that the pricing of the postal boxes, post office boxes by
24 the Postal Service could actually be a detriment to the
25 entry of new businesses, so the U.S. Postal Service is the

1 only provider in some cases but there is no barrier to entry
2 in any of the markets.

3 So if you go by the criteria of barriers to entry,
4 the Postal Service could have competitors in any given
5 market if it was profitable for other providers to get into
6 the market, to produce the product and sell it to the
7 customer for a profit.

8 Q Do you think it would be profitable for a
9 competitor to get into the market in central Wyoming?

10 A I can ask the same question about McDonald's or
11 Burger King not being available in central Wyoming either,
12 so it is a function of other factors.

13 CMRAs or McDonald's or other providers of products
14 or services get into markets for a variety of reasons --
15 population density, income, a lot of other factors,
16 demographics are looked into for any business to enter any
17 market.

18 Q Could you look at page 12 of your testimony, lines
19 9 through 11?

20 A If you could give me a minute?

21 Okay.

22 Q Here, you are discussing one of the criteria of
23 the statute, namely impact of rate increases on users; is
24 that correct?

25 A Yes.

1 Q And we are talking about the increases in Post
2 Office box fees, correct?

3 A Right.

4 Q Now, are you saying that customers whose fees are
5 going to be doubled have no cause for complaint because they
6 can always go elsewhere and pay even more?

7 A I need to repeat my statement that the pricing
8 proposal of the Postal Service is not based on one factor
9 alone. Doubling the fee would be reasonable if the Service
10 was not covering its cost.

11 Q But at this particular point in your testimony,
12 page 12, lines 9 through 11, you are talking about impact on
13 users, correct?

14 A Right.

15 Q And you are saying the impact cannot be considered
16 undue when other customers are already paying higher fees to
17 CMRAS. Did I read that correctly?

18 A That is true.

19 Q So am I to understand that large fee increases are
20 justifiable whenever you can tell the customer, if you don't
21 like it, go pay more somewhere else.

22 A I didn't say that at all. All I am saying is the
23 Postal ratemaking is not done in isolation with one criteria
24 in mind and, in fact, the doubling of the fee that you are
25 referring to was actually proposed by the OCA proposal also.

1 So apparently they thought it was fair also to propose
2 doubling of the fee for Group 2 boxes.

3 Q Let's discuss that. Can you look at page 14 of
4 your testimony, particularly lines 8 through 11?

5 A Okay, let me look at it for a minute, please.

6 Okay, I'm there.

7 Q Okay. The first sentence there says "The Postal
8 Service acknowledges that a 'one price fits all' approach
9 may not be the most efficient method of pricing post office
10 boxes." Right?

11 A That's what it says.

12 Q There are problems with the current structure of
13 fees for post office boxes, correct?

14 A If you look at page 14 completely my statements
15 have begun by saying, I began the whole thing by saying that
16 Dr. Sherman had commented on the difficulty of pricing post
17 office boxes across the nation and I am responding to that
18 concern by offering some thoughts on the subject of taking
19 into account the differences in different markets and these
20 differences could be differences in population, population
21 density, income, differences in demand, differences in cost.

22 All that I am saying is that this whole process of
23 pricing any product in a regulatory environment is an
24 evolutionary process and that requires us to sort of think
25 one step ahead and be able to see what better things can be

1 done in terms of pricing a product, so we acknowledge that
2 there are some difficulties and this is -- at least we have
3 some thoughts on the subject.

4 As I said later on in my testimony as the Postal
5 Service evaluates various approaches to pricing post office
6 box service in the future it may be useful to have feedback
7 and suggestions from interested parties including the
8 Commission, so essentially this whole page is reflecting
9 some of the thoughts on various pricing methodologies and we
10 are looking for some input in that area.

11 Q What you are suggesting at lines 16 through 19
12 would be a form of locality pricing, is that correct?

13 A First of all, let's understand what I am
14 suggesting or what I am saying on lines 16 through 19
15 essentially is one particular method that is not defined and
16 it has not been researched but this one possibility that
17 could be looked into in terms of evaluating local factor
18 differences in pricing post office boxes.

19 Q Well, you wouldn't look into this at all if there
20 wasn't some sort of perception that there is a problem,
21 would you?

22 A The differences in terms of pricing post office
23 boxes in different localities I think is not an
24 insurmountable problem but I think there are some issues
25 that we need to consider further at some future date in

1 terms of pricing them accurately given the factors in the
2 local markets and differences in those factors -- cost as
3 well as demand factors.

4 Q One of the factors you mention is population
5 density, correct?

6 A That is -- like I said earlier, that's just one
7 thought on the subject.

8 There could be a number of other factors and
9 variables that could be included in this ranking system if
10 there is going to be a ranking system of that sort.

11 Q Would you agree that there is a significant
12 difference in post office box costs between facilities in
13 densely populated areas and facilities in sparsely populated
14 areas?

15 A My testimony does not deal with that.

16 From what I have seen in other testimony, there
17 are differences in costs.

18 MR. COSTICH: Thank you.

19 I have no further questions, Mr. Presiding
20 Officer.

21 COMMISSIONER QUICK: Does any other participant
22 have oral cross-examination for Witness Taufique?

23 [No response.]

24 COMMISSIONER QUICK: Questions from the Bench?

25 [No response.]

1 COMMISSIONER QUICK: No questions from the Bench.
2 That brings us to redirect. Mr. Alverno, would
3 you like an opportunity to consult with your witness before
4 stating whether redirect testimony will be necessary?

5 MR. ALVERNO: Yes, please. Five minutes at the
6 most.

7 COMMISSIONER QUICK: Fine. Go off the record for
8 five minutes.

9 [Recess.]

10 COMMISSIONER QUICK: Mr. Alverno?

11 MR. ALVERNO: Yes, Mr. Presiding Officer. The
12 Postal Service has no redirect.

13 COMMISSIONER QUICK: Since there is no redirect,
14 there will be no further cross-examination.

15 Thank you, Mr. Taufique. We appreciate your
16 appearance here today and your contributions to our record.

17 If there is nothing further, you are excused.

18 [Witness excused.]

19 COMMISSIONER QUICK: Because of the fortuitous and
20 pleasant developments earlier in the day, this concludes
21 today's schedule.

22 I want to thank counsel for your courtesies and
23 your participation in these proceedings. I look forward --
24 I think we all look forward to reading your briefs and this
25 hearing is adjourned.

1 [Whereupon, at 10:13 a.m., the hearing was
2 concluded.]

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